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No. 589

# In the Supreme Court of the United States

OCTOBER TERM, 1959

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DANIEL W. FARNSWORTH'S EXECUTORS AND GERTRUDE A. FARNSWORTH, PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The opinion of the Tax Court (R. 47a-59a)[1] is reported at 29 T.C. 1131. The opinion of the Court of Appeals (Pet. A-3 - A-12) is reported at 270 F. 2d 660.

### JURISDICTION

The judgment of the Court of Appeals was entered on October 9, 1959. (Pet. A-2.) The petition for a writ of certiorari was filed on December 15,

[1] Record references are to the "Brief and Appendix for Petitioners" filed in the Court of Appeals.

1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## QUESTION PRESENTED

Whether the taxpayer, who voluntarily paid (in addition to his own tax liability) the New York unincorporated business tax and personal income tax liabilities of his partners, is entitled to a deduction for federal income tax purposes for the entire amount so paid.

## STATUTES INVOLVED

Section 23(a)(1)(A) and (c)(1) of the Internal Revenue Code of 1939 and Sections 386 and 386-a of the New York Tax Law are set out in the Appendix, *infra*, pp. 7-10.

## STATEMENT

For the years 1940 through 1953, the taxpayer formed and participated in successive annual partnerships, known as Farnsworth & Farnsworth, located in Montclair, New Jersey, which were engaged in the textile consultant business. A number of the taxpayer's partners were related to him. (R. 48a-50a.) Because the successive partnerships had their legal situs in New Jersey, it had been assumed that they were not subject to state taxation in New York, where the partnerships maintained an office, but in 1946 the partnerships filed New York unincorporated business tax returns allocating partnership income between New York and New Jersey. (R. 50a.) The

New York State Tax Commission refused to accept the proposed income allocation and in 1951 New York judgments were entered against the individuals who had been partners for the years 1940 through 1949 for unincorporated business taxes in the total amount of $143,388.61. The taxpayer's allocable share of the tax, interest, and penalties assessed against the partners was $17,895.84. The Commission also determined that the partners were subject to New York State income tax on individuals on their distributive shares of partnership income for 1940 through 1949. (R. 50a-52a.)

In April 1952, the taxpayer advised the partners that he would assume the entire responsibility for settling the New York State tax controversy, and in November of the same year an offer in settlement of the liability for the unincorporated business taxes and the partners' personal income taxes was accepted by the Commission, reducing the total amount of liability from $143,388.61 to $115,942.34. The taxpayer himself voluntarily paid this entire sum and did not receive, nor did he expect to receive, any reimbursement from the other partners. Of the total settlement amount, the taxpayer's own liability for unincorporated business taxes, for personal income taxes, for personal non-resident income tax, and for interest on unincorporated business taxes was $15,478.69. (R. 52a-54a.)

The Tax Court held that the payment by the taxpayer in satisfaction of the unincorporated business taxes of the several partnerships and the New York State personal income taxes of his partners was not

deductible either as taxes paid or as an ordinary and necessary business expense of the taxpayer except to the extent that the unincorporated business taxes were allocable to his interest in each partnership. (R. 56a, 58a-59a.) The Court of Appeals affirmed. (Pet. A-4 - A-12.)

## ARGUMENT

The decisions of the courts below that the payments made by the taxpayer to satisfy his former partners' personal state income taxes and their shares of the New York state unincorporated business taxes of the respective partnerships were not deductible either under Section 23(a)(1)(A) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 7) as ordinary and necessary business expenses, or under Section 23(c)(1) (Appendix, *infra*, p. 7) as taxes paid, are in accord with the statute and settled legal principles.

As indicated by the Statement, *supra*, the record shows that the taxpayer, voluntarily and for no consideration, assumed liability for the payment of his former partners'[2] personal income taxes. (R. 57a-58a; Pet. A-10.) They certainly were not the petitioner's taxes, and hence were not deductible by him. *Magruder* v. *Supplee*, 316 U.S. 394.

With respect to the unincorporated business taxes levied upon the successive partnerships by Article 16-A of New York tax law (Appendix, *infra*, pp. 7-10), the taxpayer predicates his claim to a deduction for

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[2] Half of these partners were close related to the taxpayer. (Pet. A-12, R. 49a-50a.)

taxes paid (Pet. A-9, A-12) on the fact that he, as a partner, was jointly and severally liable for the entire amount of unincorporated business taxes assessed against the partnerships. However, as both the Tax Court (R. 58a-59a) and the Court of Appeals (Pet. A-10 - A-11) pointed out, the other partners were also jointly and severally liable for such taxes, and the taxpayer under New York and New Jersey partnership law had a clear right to contribution—upon payment of the tax liability—from the other partners of their respective percentage shares of the tax. 38 McKinney's Laws of New York (1948 ed.), Sec. 40; 42 New Jersey Statutes Annotated, Sec. 1-18. Also, as both courts likewise found, the taxpayer was not compelled by business reasons to assume the entire liability without contribution. Since the taxpayer thus gratuitously waived any contribution from his other partners, undertaking on his own to satisfy the entire tax liability without expectation of reimbursement, his action was nothing more than the payment of the liabilities of his partners. Such payments are not deductible either as taxes under Section 23(c)(1) or as an ordinary or necessary expense. *Welch* v. *Helvering*, 290 U.S. 111.

## CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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FEBRUARY, 1960.

## APPENDIX

1. Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Section 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *

* * * * *

(c) [as amended by Section 202(a), Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance in general.*—Taxes paid or accrued within the taxable year * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

2. New York Tax Law, 59 McKinney's Consolidated Laws of New York Annotated, Part 2:

ARTICLE 16-A—TAX ON NET INCOMES OF UNINCORPORATED BUSINESSES

SEC. 386. DEFINITIONS

For the purpose of this article, if not inconsistent with its provisions and unless otherwise required by its context, the definitions contained in section three hundred fifty of this chapter

shall be applicable and, in addition, the words "unincorporated business" means any trade, business or occupation conducted, engaged in or being liquidated by an individual, statutory or common law trust, estate, partnership or limited or special partnership, society, association, executor, administrator, receiver, trustee, liquidator, referee, assignee, or by any other entity or fiduciary, other than a trade or business conducted, or engaged in by, or the liquidation of a trade or business of, any corporation, or any other entity subject to the tax imposed by articles nine, nine-a, nine-b or nine-c of this chapter, and include any trade or business which if conducted or engaged in by a corporation would be taxable under any of said articles; but exclude the practice of law, medicine, dentistry, architecture which under existing law cannot be conducted under corporate structure, and any other case in which more than eighty per centum of the gross income is derived from the personal services actually rendered by the individual or the members of the partnership or other entity in the practice of any other profession and in which capital is not a material income producing factor. It is not intended that an individual, partnership or other entity, other than a dealer holding property primarily for sale to customers in the ordinary course of his trade or business, shall be deemed engaged in an unincorporated business solely by reason of the purchase and sale of property for his or its own account or that an owner, lessee or fiduciary shall be deemed so engaged solely by reason of the holding, leasing or managing of real property or that an individual shall be deemed so engaged with re-

spect to compensation for services rendered by him as an employee, or as an officer of a corporation, society or association, or of a state, municipality or other political subdivision of a state, or as an executor, administrator, receiver, trustee, liquidator, referee, assignee or other fiduciary, unless such compensation constitutes receipts of a business regularly carried on by such individual. A person shall not be deemed to be engaged in an unincorporated business solely because of selling goods, wares and merchandise for more than one person, firm or corporation unless he maintains an office or employs one or more assistants or otherwise regularly carries on a business.

SEC. 386-a. IMPOSITION OF TAX

A tax is hereby imposed upon the entire net income of any unincorporated business wholly or partly carried on within this state during each taxable year equal to four per centum of the entire net income within this state of such unincorporated business and shall be payable by the taxpayer conducting the same provided, however, that the tax upon the entire net income of any unincorporated business wholly or partly carried on within this state during the calendar years nineteen hundred forty-five, nineteen hundred forty-six, nineteen hundred forty-seven, nineteen hundred forty-eight, nineteen hundred forty-nine, nineteen hundred fifty, nineteen hundred fifty-one, nineteen hundred fifty-two, and nineteen hundred fifty-three, or, in case a taxpayer's accounts are kept on a fiscal year basis, for any fiscal year ending during the calendar years nineteen hundred forty-six, nineteen hundred

forty-seven, nineteen hundred forty-eight, nineteen hundred forty-nine, nineteen hundred fifty, nineteen hundred fifty-one, nineteen hundred fifty-two, nineteen hundred fifty three, and nineteen hundred fifty-four, or, in case a taxpayer is required to file a return for a period of less than a year, for any period of less than a year ending during the calendar years nineteen hundred fifty, nineteen hundred fifty-one, nineteen hundred fifty-two, nineteen hundred fifty-three, and nineteen hundred fifty-four, shall be equal to three per centum of the entire net income within this state of such unincorporated business. The taxes imposed by this article shall be in addition to any other taxes imposed by this chapter or any other law.

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